

 **Hershey Foods Corporation 1974 Annual Report**





Annual Meeting

The Annual Meeting will be held at 2 p.m. on Monday, April 14, 1975, at the Hershey Motor Lodge and Convention Center, Route 322 and University Drive, in Hershey.

A formal notice of this meeting, together with a proxy statement, will be mailed to stockholders on or about March 17, 1975.

Stockholders who are unable to attend the meeting are urged to sign and return their proxies promptly so the stock of the company will be represented as fully as possible at the meeting.

Form 10-K

The Annual Report to the Securities and Exchange Commission on Form 10-K is available upon written request to the Secretary of the Corporation.

Principal Securities Market

The common stock is listed on the New York Stock Exchange.

Board of Directors

H. S. Mohler, *Chairman*

W. E. Dearden

J. Hemphill

*Director of Cocoa Bean Purchases
and Assistant Treasurer,
Hershey Foods Corporation*

J. C. Jamison

*investment banker, Partner,
Goldman, Sachs & Co., New York, N. Y.*

S. A. Schreckengaust, Jr.

*attorney at law, Executive
Partner, McNees, Wallace &
Nurick, Harrisburg, Pa.*

L. C. Smith

R. L. Uhrich

R. A. Zimmerman

Officers

H. S. Mohler

Chairman of the Board and President

W. E. Dearden

Group Vice President

J. S. Harkins

*Vice President, Finance and
Administration*

O. C. Johnson

Vice President, Scientific Affairs

L. C. Smith

Vice President, Engineering

R. L. Uhrich

Vice President and Secretary

R. A. Zimmerman

Group Vice President

L. W. Simmons

Treasurer and Comptroller

Executive Offices

19 East Chocolate Avenue
Hershey, Pa. 17033

Transfer Agent

First National City Bank
New York

Registrar

Morgan Guaranty Trust
Company, New York

Auditors

Arthur Andersen & Co.
New York



CLEVELAND PUBLIC LIBRARY
BUSINESS INF. BUR.
CORPORATION FILE

1974 Highlights

	1974	1973	% Change
Net sales	\$513,999,000	\$442,710,000	+ 16.1
Net income	\$ 22,094,000	\$ 14,306,000	+ 54.4
Net income per common share	\$1.70	\$1.10	+ 54.5
Dividends per share—			
Common stock	\$.80	\$1.10	— 27.3
Preferred stock	\$.60	\$.60	—
Dividends paid	\$ 9,699,264	\$ 13,246,502	— 26.8
Capital expenditures	\$ 10,887,000	\$ 17,564,000	— 38.0
Stockholders' equity	\$173,173,000	\$160,777,000	+ 7.7
Equity per common share and equivalent at year end	\$13.30	\$12.34	+ 7.8
Outstanding common shares at year end	11,824,000	11,824,000	—
Market prices of common stock—range during: First Quarter	\$ 12¼-15	\$ 18⅝-24¾	
Second Quarter	\$ 10¼-13⅜	\$ 15 -19½	
Third Quarter	\$ 8⅝-11¼	\$ 13¾-17	
Fourth Quarter	\$ 8½-11	\$ 12½-16½	

Quarterly dividends of 20¢ per share were paid on common stock in 1974 compared with 27½¢ per share for 1973. Quarterly dividends of 15¢ per share were paid on the preferred stock in both years.



Hershey Foods Corporation
and Subsidiaries



Harold S. Mohler
*Chairman of the Board
and President*

To Our Stockholders:

IN 1974 your Company achieved record sales of \$513,999,292—an improvement of 16% over those of the previous year. Consolidated net income was \$22,094,158—up 54% over that reported for 1973. Earnings per share in 1974 were \$1.70 and in 1973 were \$1.10.

The 1974 earnings reflect a return to the levels achieved by the Company prior to the recent period of price controls during which increased costs of doing business could not be reflected in selling prices in a timely fashion.

During the past year, our Chocolate and Confectionery Division experienced rapidly escalating prices of the principal raw materials used

in the manufacture of its products. A 50% increase in the price of cocoa beans and a 400% increase in the price of sugar required substantial changes in product line during the course of the year, including the transition to 15¢ bars from the 10¢ bar lines.

Recently a new item was introduced—Dark Chocolate Flavored Baking Chips—which contains, as a substitute for most of the cocoa butter normally found in chocolate products, a high-grade vegetable fat which is considerably lower in cost than the cocoa butter it replaces. This, we feel, is a successful attempt at finding substitutes for ingredients whose cost increase has been extreme.

The skyrocketing price of sugar, caused by a number of factors including poor growing weather, increased demand worldwide, and speculation, is a cause for concern in the entire food industry. The

Corporate Officer and Director Changes

William E. Schiller, Chairman of the Board of Directors, retired on March 1, 1974, under the Company's policy of mandatory retirement at age 65. Mr. Schiller joined Hershey in 1947 as Comptroller after having been employed for 14 years in the Chicago and New York offices of Arthur Andersen & Co., an international firm of public accountants. He was named Treasurer and Comptroller in 1948 and was elected to the Board of Directors in the same year. In 1956 he was elected Vice President and Treasurer, and in 1965 he assumed the Board chairmanship. During his

long years of devoted and dedicated service, Mr. Schiller held top management positions and contributed significantly to the growth and development of this firm.

Also retiring as directors by reason of age were Arthur R. Whiteman and James E. Bobb. Both men devoted their entire business careers to the Hershey interests and played major roles in the development of the community of Hershey and its enterprises. Mr. Whiteman was a director of Hershey Foods Corpora-

price of this commodity has declined from its peak; but unless a drop to more reasonable levels occurs, further increases in the prices of our products will be necessary.

Your Company decided to extend LIFO (last-in, first-out) inventory accounting to sugar and packaging materials in its Chocolate and Confectionery Division effective January 1, 1974. This will more realistically match current costs against revenue and reduce the effect of inflation on earnings and improve cash flow.

Last October, we acquired an interest in Chadler Industrial da Bahia S.A., a cocoa bean converter located at Salvador, Bahia, Brazil, with the objective of exerting an influence on the quality of the semi-processed products such as chocolate liquor, cocoa butter and cocoa powder which are increasingly being produced in the cocoa growing countries.

In another part of this report the operations of our subsidiary companies are summarized. As noted there, the sales and earnings

of Cory and of the pasta companies were comparable with those of 1973 even though raw material costs were somewhat higher. The operating results of Portion Control Industries were very disappointing, and action to reverse this situation has already been taken and will continue.

With the forces of inflation and recession continuing to be unpredictable, it is difficult to forecast how our various divisions and companies will fare. Our manufacturing, marketing, and purchasing expertise, as well as our capital resources, shall be dedicated to en-

suring that we retain and, if possible, improve our share of the markets in which we operate.

We want to thank especially our thousands of loyal and industrious employees who have worked diligently to reduce costs and improve the quality of our products.

H. S. Mohler

Chairman of the Board
and President

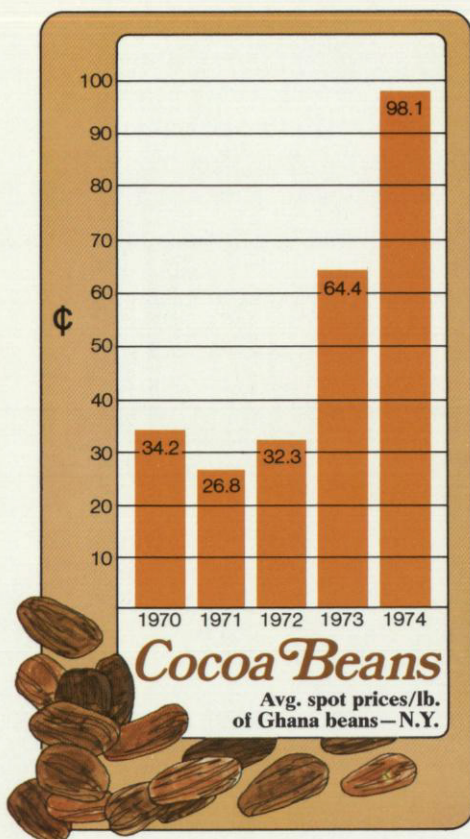
tion for the past fourteen years, and Mr. Bobb was a member of the Board since 1970.

John C. Jamison, a partner of Goldman, Sachs & Co., New York, was elected a director on April 8, 1974. Mr. Jamison, a native of Lafayette, Indiana, holds degrees from Purdue University and Harvard Graduate School of Business Administration. He has been with Goldman, Sachs since 1961.

Dr. Ogden C. Johnson, former Director of the Office of Nutrition and Consumer Studies, Bureau of Foods, Food and Drug Administration (HEW), joined

the Company as Vice President of Scientific Affairs on March 1, 1974. Dr. Johnson is responsible for directing research, quality assurance, and laboratory activities for the Corporation.

John S. Harkins joined the Company as Vice President of Finance and Administration on September 1. Mr. Harkins was most recently employed by Borden, Inc., New York, where he held the position of General Controller since 1969. His principal responsibilities with Hershey include financial, accounting, and corporate information systems functions.



Chocolate and Confectionery Division

	1974	1973
Sales (in Millions) ..	\$419.2	\$351.0
% Change	+19%	
Operating Income (in Millions)	\$ 49.6	\$ 31.1
% Change	+59%	

In 1974, the Chocolate and Confectionery Division achieved record sales. This sales growth was accompanied by significant improvement in operating income.

The overall positive performance in sales and operating income was accomplished despite unprecedented increases in the costs of raw materials—notably sugar and cocoa beans—accompanied by problems resulting from price controls, shortages of raw materials, energy cost increases, the continuing rise in wages, and soaring costs of purchased services, supplies, equipment and transportation.

Raw Materials

Most important of the raw materials used by this Division is, of course, cocoa beans. Since this is a tropical crop and not a pound of it is grown in the United States, we have very little control over its production and marketing. Approximately two thirds of the raw crop is grown in West Africa, and most of the balance is grown in Central and South America.

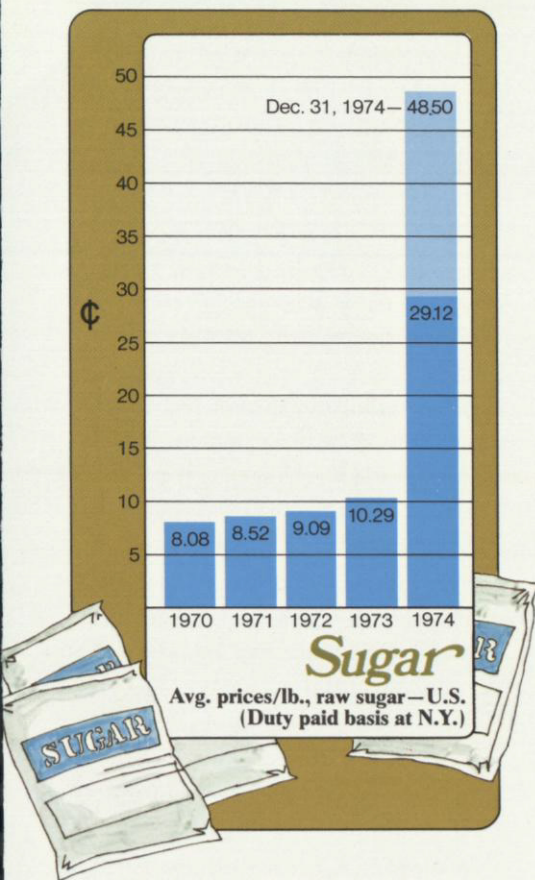
The past crop was similar in size to the preceding one with increased production in West Africa being offset by a decline in the Brazilian crop. Weather conditions, mostly long dry periods, in principal producing countries over the past several years have prevented an increase in production even though much higher prices paid to the producers should have been an incentive for such an increase.

As with most raw materials throughout the world, the demand for cocoa beans has exceeded harvest for the past several years. This has caused a dramatic increase in the price of this commodity, but these same high prices have had the effect of reducing consumption. During the fourth quarter of 1974, the amount of cocoa beans used in the United States was 27 percent lower than for the same period in 1973. Somewhat similar results were experienced in other parts of the world. This should have the effect of balancing supply and demand and, hopefully, lowering the cost of this commodity to a more reasonable level.

The dramatic increase in the price of sugar this past year has been unprecedented for any agricultural commodity. The price of raw sugar in the United States was 11.3¢ per pound (spot price in New York) at the beginning of 1974 and reached a high of 66.5¢ per pound in November. Since then, the price has declined about 35 percent but still remains abnormally high.

Unfavorable weather conditions for the growing of sugar in parts of Europe and the United States resulted in the supply of sugar worldwide being considerably lower than the anticipated demand. This, together with a certain amount of speculation, caused the price to rise considerably above anything warranted by the temporary deficit in supplies.

Generally not recognized is the fact that over the past twenty years the consumption of sugar throughout the world has increased at a rate much faster than that for any other food. While the increase in the United States was not as pronounced, the relatively low price of sugar did not stimulate increased production, and the culmination last year of poor crops and increased demand caused the unprecedented price levels.



While extremely high prices for sugar are being experienced in the U.S., most of the other consuming countries either control or subsidize the price of sugar; consequently the higher prices have not impacted on demand as they would have in a free market. Consumption in the United States has declined and will probably continue to do so until the planned increased production of sugar is harvested next fall. Given reasonably good weather, a balance of supply and demand should occur, and prices should recede substantially.

Milk is purchased from about 1,000 farms in the vicinity of our plants. All of it is picked up by bulk tank units directly from the farms, and the volume amounts to approximately 400,000,000 pounds annually. That which is surplus to our needs is sold primarily to the bottled market. The supply of milk has been adequate, and the price has remained relatively stable compared to other commodities.

One commodity which per-

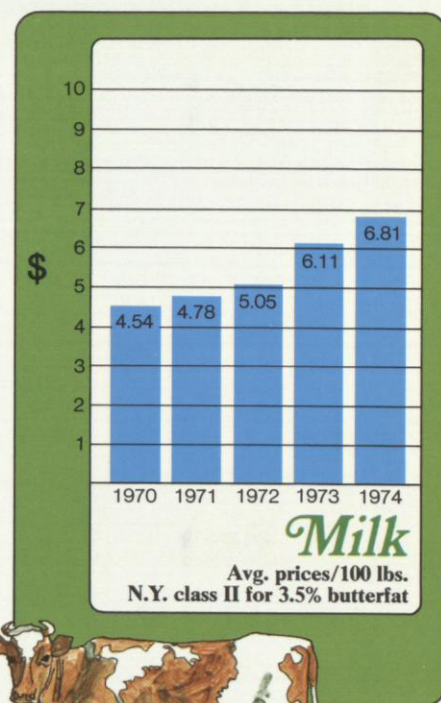
formed contrary to the trend during 1974 was almonds, of which this Division uses sizeable quantities. The California almond crop established an all time record as it showed an increase in volume of 50 percent over the 1973 crop. This caused a 35 percent decrease in the price of almonds.

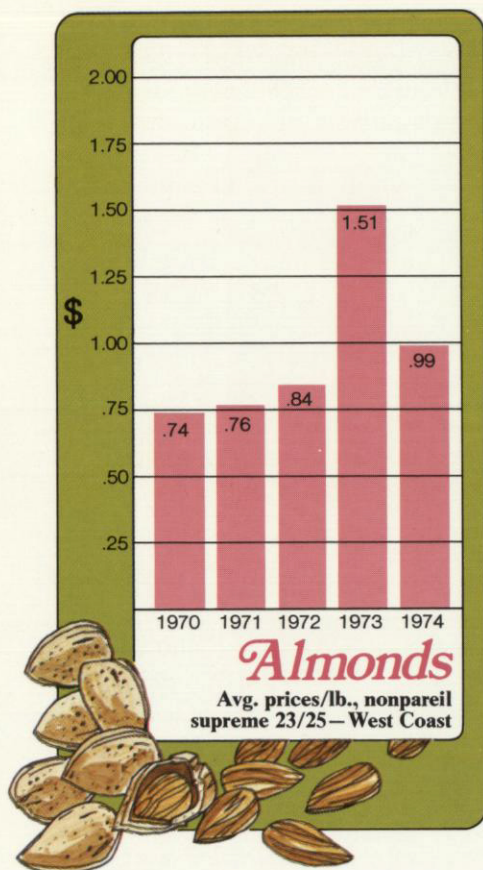
L. D. Properties Corporation, a subsidiary company, harvested an excellent crop from its approximately 5,000 acres of almond trees, which are now approaching maturity. Despite the significantly larger California almond crop and the consequent drop in worldwide almond prices from record levels of 1973, this subsidiary continues to provide a good return and has proved to be an excellent investment.

Hershey is one of the larger users of peanuts in the country. There is more than an adequate supply of peanuts domestically, although the type and quality we require are not always available in unlimited quantities. Peanuts is one of the "basic" crops with its price supported by the federal government. As can be seen in the nearby chart, the price of this commodity remained fairly stable until last year.

Products

Record sales were realized in 1974, primarily in the Division's established product lines, though all confectionery and grocery products recorded higher sales in dollars. Price increases implemented during the year were an important factor in the dollar sales growth. The response of both our customers and the consumer to the price in-





creases and product line changes was considerably more positive than anticipated.

Remarkable growth of the Kit Kat bar continued. Sales are not on a national basis as yet because we have been unable to produce sufficient product to meet demand; but this will be remedied with the addition of a new Kit Kat manufacturing line scheduled to be in production at the Reese plant by mid-1975.

Grocery products—Syrup, Instant, Cocoa and Chocolate Baking Chips—maintained good levels of sales in poundage despite necessary price increases. It appears that demand for these items remained strong because the housewife returned to baking at home when prices for cake mixes and bakery store products went higher.

In December the Division announced the introduction of a new high quality dark chocolate flavored baking chip to replace Hershey's Semi-Sweet Chocolate Chips. This new product—Dark Chocolate Flavored Baking Chips—differs from the semi-sweet chocolate chips in that a portion of the cocoa butter has been replaced with a combination of other fine quality vegetable oils.

From functional and nutritional perspectives the substituted vegetable oils and cocoa butter are equivalent, and extensive test marketing has convinced us that we have a product that offers the consumer a high quality baking chip at a cost lower than that which could be expected for the product we replaced.

Also introduced during 1974, were two more brands of Rowntree Mackintosh Ltd., of York, England—Quality Street and Toffo. A high quality assortment of individually wrapped toffees and chocolates, Quality Street was test marketed early in 1974 in certain markets and was made available nationwide starting in September, 1974. Toffo, in rolls of bite-size, individually wrapped caramels, was offered in selected test areas starting in December, 1974.

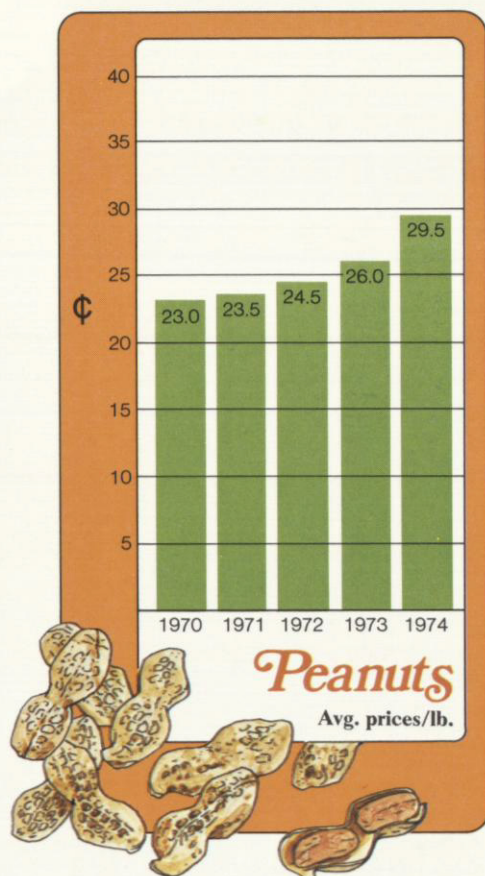
After Eight, the chocolate covered thin mint of Rowntree Mackintosh, introduced in several test areas in late 1972, has been withdrawn from our line because the escalating retail prices substantially reduced consumer pickup.

During 1975 we shall continue to consider internally generated new products as well as additional Rowntree Mackintosh items for introduction into the U.S. market.

Price Increases

The year 1974 was one of considerable turbulence, both before and after the Federal Government removed price controls on April 30. Price increases and weight reductions approved by the Cost of Living Council were made in January. These changes were marked by replacement of the 10¢ bar with a line of 15¢ bars. Continued escalation of the costs of basic raw materials necessitated additional price increases and weight adjustments, and these were effected in May, September, and December.

Because of circumstances evident through the year, consumer advertising was virtually eliminated in 1974. In 1975 the program has been resumed and will be an important part of our total marketing effort.



The accomplishments of the Division in both sales and earnings during 1974 attest to the effectiveness of our people in overcoming the multiple problems resulting from price controls, shortages of certain raw materials, and record-setting costs of raw materials.

Equally important is the fact that our people did not lose sight of the fundamental strengths of the Division—the broad consumer franchise built upon the faith and trust of the American consumer in the quality and value received in Hershey's products.

Consequently, highest priority has been placed upon the monitoring and accurate measurement of consumer reaction and purchase behavior during this period in which rising costs require frequent adjustments in product lines and prices.

Hershey Chocolate of Canada

Our Canadian Organization faced the same problems of unprecedented raw materials costs and other higher business costs as experienced in the U.S.A. While dollar sales increased, much of the rise resulted from price increases of products sold. Sales in units were lower.

Retail prices of bars rose from 12¢ to 15¢ to 20¢ during 1974. This rapid escalation of prices generated confusion among consumers and resulted in a substantial decline in sales industrywide. The unsettled atmosphere has not yet been fully overcome and continues to impact negatively on unit sales.

Despite these problems, losses incurred for the previous year were reduced significantly, and operations were on nearly a breakeven basis in 1974. The outlook for 1975 is one of cautious optimism with continued sales growth expected.

Food Products and Food Services

	1974	1973
Sales (in Millions) ..	\$ 94.8	\$ 91.7
% Change		+3%
Operating Income (in Millions)	\$ —	\$ 2.8
% Change		—100%

Cory Food Services

Cory Food Services, Inc., formerly Cory Corporation, made significant changes in its long-range business plans and style in 1974. Concentration is being placed upon equipment supply to the food service industry and Cory's coffee service business.

Two divisions have been created. Cory Products Division manufactures food service equipment including coffee brewers, glass decanters, food warmers, and stoves.

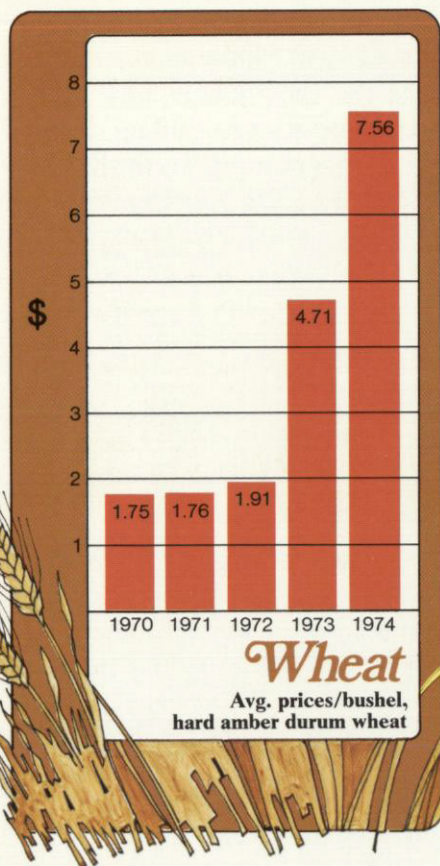
The product line has been trimmed by eliminating humidifiers, dehumidifiers, fans and heaters; consumer products continuing in the line are automatic coffee makers, glass brewers and decanters. This pruning permitted the consolidation of all manufacturing into one location in Chicago with significant cost savings.

Cory Coffee Services Division, formerly Cory Coffee Service Plan, Inc., continues its growth in the office coffee service business. Its name change, however, reflects new areas under market development such as an office carbonated beverage program and an office water purification system.

Sales growth in all divisions was satisfactory during 1974, but profits were below expectation. Sugar price increases, coupled with higher than expected coffee prices, eroded profit margins. Late 1974 price increases have offset, to some degree, these costs.

In July, 1974, Therm Industries, Inc. was acquired by Cory. Therm, located in St. Charles, Ill., produces specialty aluminum castings and heat transfer equipment primarily for the food service business.

On September 1, 1974, George E. Wilber, Jr. was elected President and Chief Executive Officer. J. W. Alsdorf continues as Chairman of the Board.



San Giorgio Macaroni

Hershey's pasta brands, San Giorgio and Delmonico, experienced nearly 33% sales increases during 1974. Although higher selling prices accounted for much of these increases, penetration in each market held firm or increased. The San Giorgio frozen food line is proving to be quite successful when measured against anticipated distribution in key retail markets.

Flour costs continued at their high levels. In this commodity, as in many others, small carry-over stocks served to buoy the market. In addition, the purchase of United States wheat by foreign countries, as widely reported in the press, and uncertainties about the role the United States will play in the world food market have exerted additional pressure on the commodity. Thus, consumers are now paying as much as 50¢ per pound for dry spaghetti and macaroni, but even at that price they remain one of America's best buys.

Effective January 1, 1975, Delmonico Foods was merged into San Giorgio. A single management team—from president to finance to sales and marketing—has been created. Manufacturing operations will continue at both the Louis-

ville, Ky., and Lebanon, Pa., plants. Additional capacity was made available at each location in 1974 and further additions are planned.

Willoughby S. Dade retired on January 31, 1975, as President of San Giorgio having reached the Company's mandatory retirement age. Joseph P. Viviano, formerly President of Delmonico, was elected to replace him.

Portion Control Industries

A disappointing year was experienced by Portion Control Industries and its major operating subsidiary, National Portion Control.

Major steps taken to alleviate this situation include deemphasizing our involvement in school lunch programs, closing of a smaller plant in South Holland, Illinois and reduction of personnel. Though National Portion Control continues as a supplier to the nation's schools, it is offering only selected products in selected regions. This results from a reduction of the general product line, which is designed to generate longer production runs.

Economies of production are also being realized at our main manufacturing plant in Chicago, where a major addition has been completed and is in operation.

Raw material prices of beef declined significantly during 1974. However, virtually all reduced costs have been passed along to our customers because competition remains intense.

Though Portion Control Industries continues to be the main detractor from corporate profitability, we are working diligently to turn this situation around, and we are confident we shall be successful.

Mr. Mohler expresses Hershey's corporate viewpoint on some important issues

Nutritional Labeling

Within the past two years we introduced nutritional labeling on several chocolate and confectionery products as well as fortified products in the pasta division. The program initiated in the pasta division involved a mandatory requirement of the Food and Drug Administration. Our decision in the Chocolate and Confectionery Division was strictly voluntary. We firmly believe that it is a most appropriate course of action to provide consumers with nutritional information regarding our products.

Children's Advertising

We are quite sensitive to the developments related to children's advertising, whether they spring from the Federal Trade Commission, industry, self-regulating organizations or other sources. All of our commercials are reviewed

and approved by individuals representing various disciplines within the Corporation. Additionally, we have retained outside expertise in the area of measuring the impact of advertising on children to ensure that our commercials are neither false nor misleading nor have the potential to be misunderstood by children.

We are, as a corporation, committed to advertising our products to all market segments, including children; and we realize that we have an even greater responsibility when we direct commercials to children.

Food Advertising

The Federal Trade Commission recently proposed a regulation which would require food advertisers to comply with certain procedures when referencing the nutritional value of the advertised product.

The medium of television has received credit for being the most powerful communications mode; thus, we have experienced an attempt to control the types of messages a food advertiser can use on the air. The mechanisms the FTC would require advertisers to follow leave serious doubt as to whether they will, in fact, achieve the program objectives.

We believe nutritional education will demand a total communications approach. This includes commercials, labeling, point of purchase materials, and other educational tools. To concentrate on advertising alone is not enough.

We are hopeful that a position acceptable both to the FTC and the

food industry can be realized in the near future. Otherwise, there could exist the potential for misconception and misunderstanding relative to the role of nutrition in the diet, as well as other factors related to why people consume foods.

Product Safety

We believe the single most important issue confronting food manufacturers today as they prepare long-range programs involves the ability of a company such as Hershey to provide consumers with a safe product, free from health hazards to the maximum extent possible, while simultaneously ensuring that traditional quality is maintained.

In the recent Congress, legislation was introduced to require

manufacturers to meet certain specifications. We believe that food processors know their industry best and should develop safety procedures and programs to ensure the quality and safety of their products. We would concede that the Food and Drug Administration should have the responsibility to monitor the programs that we as manufacturers would develop. Hopefully, the Congress will realize the logic of this procedure.

For some time this Corporation has had self-certification programs in effect at the chocolate and confectionery plant in Oakdale and the San Giorgio plant in Lebanon. Accepted by the Food and Drug Administration as part of its Cooperative Quality Assurance Program, our own programs involve, to a degree, self-regulating activities. They are based upon adherence to a set of quality assurance specifications satisfactory to both the FDA and Hershey. They require reporting to the FDA all deviations from those specifications at those plants. We are now about to include the Reese plant in the self-certification procedure.

Currently, a format has been devised by our scientific affairs, finance and government relations departments to develop a more sophisticated procedure in connection with a second generation of

the FDA's self-certification program. We thereby hope to ensure that Hershey is among the leaders in the food industry on quality and health matters.

Energy & the Environment

The Corporation has a basic responsibility to comply with all government regulations. In recent years, we have seen much activity in the area of environmental affairs. Fortunately, our approach has been professional, and we have not only kept abreast of these regulations but also have developed programs to ensure that we are in compliance before law dictates that we adhere to certain specifications.

We are concerned about the availability of energy in this country, since several regulations on air pollution were written prior to the current energy shortage. We constantly monitor these factors to ensure that we can operate our facilities while complying with governmental requirements.

More Regulations

Perhaps every manager in a corporation our size feels that the regulations and requirements of government complicate the decision making process. We must concede, however, that much legislation directed to industry results from voids in the competitive market-

place and the necessity of ensuring that products are manufactured and marketed with safety, quality and fairness in mind.

Unfortunately, in the development of these regulations and requirements, total costs are not adequately evaluated. We would like to see economic impact statements required in the future so that consumers can more fully appreciate both the developmental and pass-through costs of new programs.

Government Relations

Hershey believes a close working relationship with the government is necessary to maintain our position of leadership in our industry. We maintain a sensitivity to trends in the legislative field that may impact on our business. When appropriate, we furnish information and data which is helpful in establishing reasonable laws and regulations.

The Company has introduced manufacturing programs, labeling declarations and other procedures in advance of the date required for compliance by the government. Although it is not our intent to be the pioneer in every endeavor, we do plan for early adoption of programs required of us by the public sector.

Management's Discussion and Analysis of the Summary of Operations

The financial comments relate to the current two year comparative results of operations as well as the five year financial summaries contained on pages 12 and 21.

During the five years ended December 31, 1974, Hershey Foods Corporation experienced continued growth in consolidated net sales. Earnings have also continued to grow except for 1973 when government price controls adversely affected earnings.

Sales—Consolidated net sales increased \$71,289,000 or 16% in 1974 compared with 1973, the largest increase coming from the Chocolate and Confectionery Division. Several general price increases were put into effect in 1974 in an effort to offset the spiraling increase in costs of production, primarily costs of materials. Although sales dollars increased substantially, actual poundage of product declined. This decline in volume was a result of several bar weight reductions of many of the chocolate and confectionery items.

Sales dollar increases throughout the five year period were also a result of the transition from the 10¢ to 15¢ chocolate bar. The other segments of the business continued to show sales increases during the five year period.

Expenses and Income—In 1973 earnings were adversely affected by government price controls which did not allow a timely pass-through of costs. The situation was further aggravated since many of the Company's raw

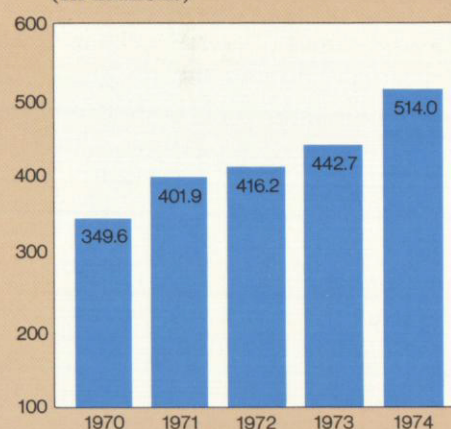
materials are agricultural commodities which were not covered by price controls and increased in cost during the year. The Company reduced inventory quantities, primarily cocoa beans, and this reduction resulted in a liquidation of LIFO inventory quantities which reduced cost of sales by \$4,500,000 and increased net income by approximately \$2,140,000 or \$.16 per share.

During the year 1974, the Company experienced unprecedented increases in virtually all major raw material costs. These costs began to escalate rapidly in 1973 and continued to do so in 1974. The most significant increases in costs were in sugar and cocoa beans.

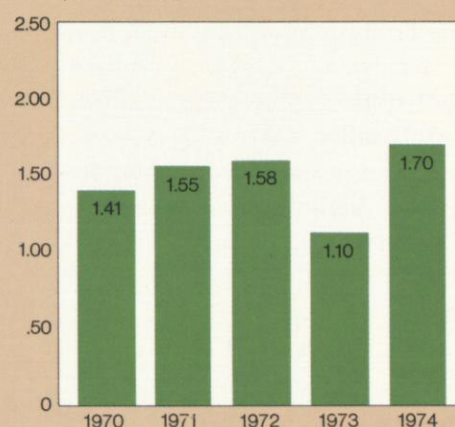
For many years, a substantial portion of the Company's major raw materials, goods in process and finished goods have been stated at cost under the LIFO method. In 1974 the Company extended LIFO inventory accounting to sugar and certain packaging materials in its Chocolate and Confectionery Division in order to more realistically match current costs against revenue and reduce the effect of inflation on earnings. The effect of the change was to increase cost of sales by \$12,444,000 and decrease net income by \$6,002,000 or \$.46 per share.

Interest costs for the four years preceding 1974 had been increasing to meet the demands of the business for working capital and capital additions. Interest declined in 1974 compared with 1973 due to an improved cash position resulting from a reduction in working capital requirements for most of the year for inventories, improved earnings, a reduction in dividends and lower capital additions.

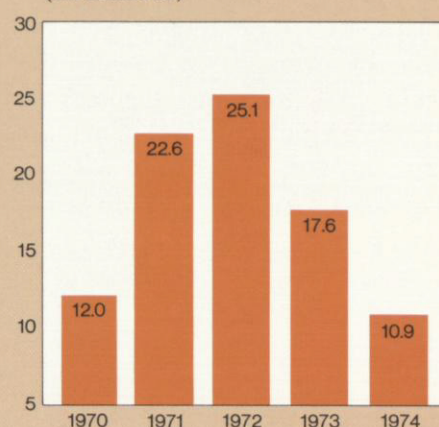
Net Sales
(In millions)



Net Income Per Share
(In dollars)



Capital Expenditures
(In millions)



Commencing in 1969, the Company entered into domestic consumer advertising for the Chocolate and Confectionery Division. The impact of advertising is stated in the five year financial summary. With the increased pressure to reduce costs, advertising was reduced in 1973 and was virtually eliminated in 1974.

Net income was \$22,094,000 in 1974 compared with \$14,306,000 in 1973 or an increase of 54%.

Operating Income—The Chocolate and Confectionery income in 1974 has recovered to the general level of earnings experienced in years prior to 1973. The principal detractor from earnings of Food Products and Food

Services has been Portion Control Industries which has incurred losses beginning with 1972. The remaining companies were profitable in 1974.

Capital Additions—During 1974 capital additions amounted to \$10,887,000. Of this amount depreciation expense provided \$8,606,000. During the last five years the Company spent \$88,202,000 or an average of \$17,640,000 annually for plant expansion and improvement.

Dividends—The Company completed 45 years of uninterrupted dividends, dating back to 1930. With the payment on December 13, 1974 the Company paid 180 consecutive quarterly

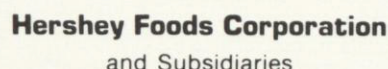
dividends on common stock.

Cash dividends of \$9,699,264 were paid on the Company's capital stock in 1974, compared with \$13,246,502 in 1973. Dividends in 1974 on Common Stock were \$.80 per share and on Preferred Stock, \$.60 per share.

Revenue Bond Offering—The Board of Directors, on February 19, 1975, approved the financing of certain pollution control and environmental capital expenditures through Industrial Development Revenue Bonds. The proposed issue of such tax exempt bonds would be approximately \$4,000,000 to cover expenditures expected to be made during 1975 and 1976.

Sales and Income by Class of Products (dollars in thousands)

	1974		1973		1972		1971		1970	
	\$	%	\$	%	\$	%	\$	%	\$	%
Net Sales										
Chocolate and Confectionery Products	419,225	82	351,016	79	335,042	81	308,884	77	260,732	75
Food Products and Food Services	94,774	18	91,694	21	81,129	19	92,996	23	88,904	25
Total	<u>513,999</u>	<u>100</u>	<u>442,710</u>	<u>100</u>	<u>416,171</u>	<u>100</u>	<u>401,880</u>	<u>100</u>	<u>349,636</u>	<u>100</u>
Income										
Chocolate and Confectionery Products	49,559	100	31,077	92	42,425	95	41,772	92	35,964	81
Food Products and Food Services	13	—	2,830	8	2,192	5	3,746	8	8,271	19
Operating Income	<u>49,572</u>	<u>100</u>	<u>33,907</u>	<u>100</u>	<u>44,617</u>	<u>100</u>	<u>45,518</u>	<u>100</u>	<u>44,235</u>	<u>100</u>
Interest, income taxes and certain general corporate expenses	27,478		19,601		23,975		25,025		25,377	
Net Income	<u>22,094</u>		<u>14,306</u>		<u>20,642</u>		<u>20,493</u>		<u>18,858</u>	



For the Years Ended
December 31

The accompanying notes are an integral part of these statements.



Consolidated Balance Sheets

Assets

	December 31	
	1974	1973
Current Assets:		
Cash	\$ 8,608,713	\$ 7,326,279
Commercial paper and certificates of deposit	<u>14,435,000</u>	<u>—</u>
Accounts receivable (less allowances for discounts and bad debts of \$933,724 and \$842,262)	<u>29,230,491</u>	<u>27,325,712</u>
Inventories: (Note 1)		
Raw materials	38,252,984	29,944,118
Goods in process	4,685,771	4,922,231
Finished goods	<u>28,958,658</u>	<u>27,587,701</u>
	<u>71,897,413</u>	<u>62,454,050</u>
Total current assets	<u>124,171,617</u>	<u>97,106,041</u>
Property and Equipment, at cost:		
Land	4,824,912	4,824,912
Buildings	63,029,265	64,133,714
Equipment	<u>130,463,695</u>	<u>124,191,654</u>
	<u>198,317,872</u>	<u>193,150,280</u>
Less—accumulated depreciation	<u>73,325,700</u>	<u>69,442,158</u>
	<u>124,992,172</u>	<u>123,708,122</u>
Goodwill	<u>17,812,802</u>	<u>17,561,503</u>
Other Assets:		
Deferred almond ranch development expenses	5,520,541	5,865,575
Deferred coffee service location costs	2,907,621	3,267,729
Investments in affiliated companies (at cost plus equity in undistributed income)	2,929,976	1,485,887
Other deferred charges	<u>2,903,476</u>	<u>3,163,655</u>
	<u>14,261,614</u>	<u>13,782,846</u>
	<u>\$281,238,205</u>	<u>\$252,158,512</u>

The accompanying notes are an integral part of these balance sheets.

Liabilities and Stockholders' Equity

	December 31	
	1974	1973
Current Liabilities:		
Loans payable within one year (Note 7) . . .	\$ 567,333	\$ 854,463
Accounts payable	37,175,975	12,877,055
Accrued liabilities	7,701,972	8,127,467
Income taxes payable	12,134,145	1,597,388
Total current liabilities	<u>57,579,425</u>	<u>23,456,373</u>
 Long-Term Debt (Note 7)	 <u>31,729,993</u>	 <u>51,470,402</u>
 Deferred Income Taxes	 <u>18,755,704</u>	 <u>16,454,653</u>
 Stockholders' Equity (Notes 3 and 4):		
Capital Stock		
Cumulative Preferred Stock—		
Authorized 2,000,000 shares; issued		
400,000 convertible shares with dividend		
rate of \$.60 per year	1,200,000	1,200,000
Common Stock, without par value—		
Authorized 20,000,000 shares; issued		
12,528,710 shares	9,391,496	9,391,496
Retained Earnings	182,948,899	170,554,005
	<u>193,540,395</u>	<u>181,145,501</u>
Less—Treasury Stock, at cost—704,629 and		
704,714 common shares	(20,367,312)	(20,368,417)
Total stockholders' equity	<u>173,173,083</u>	<u>160,777,084</u>
	<u>\$281,238,205</u>	<u>\$252,158,512</u>



Hershey Foods Corporation
and Subsidiaries

The accompanying notes are an integral part of these balance sheets.



Hershey Foods Corporation
and Subsidiaries

Consolidated Statements of Changes in Financial Position

For the Years Ended
December 31

1974 1973

Financial Resources Provided

Operations:

Net income	\$22,094,158	\$ 14,305,573
Depreciation	8,606,046	7,506,370
Deferred income taxes	2,301,051	1,594,518
Total provided from operations ...	<u>33,001,255</u>	<u>23,406,461</u>
Proceeds from debt financing	—	18,925,418
Other	1,711,789	2,069,602
Total resources provided	<u>34,713,044</u>	<u>44,401,481</u>

Financial Resources Applied

Cash dividends	9,699,264	13,246,502
Capital expenditures	10,886,758	17,564,095
Reduction in long-term debt	19,740,409	18,819,460
Investments in affiliates	1,444,089	—
Total resources applied	<u>41,770,520</u>	<u>49,630,057</u>

Decrease in working capital	<u>\$ (7,057,476)</u>	<u>\$ (5,228,576)</u>
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Details of increase (decrease) in working capital:

Cash	\$ 1,282,434	\$ (826,464)
Commercial paper and certificates of deposit	14,435,000	—
Accounts receivable	1,904,779	1,032,935
Inventories	9,443,363	(11,767,389)
Current maturities of long-term debt	287,130	6,148,895
Accounts payable	(24,298,920)	(1,782,618)
Accrued liabilities	425,495	611,899
Income taxes payable	(10,536,757)	1,354,166
Decrease in working capital	<u>\$ (7,057,476)</u>	<u>\$ (5,228,576)</u>

The accompanying notes are an integral part of these statements.



Hershey Foods Corporation
and Subsidiaries

NOTES

1.

Summary of Significant Accounting Policies

The significant accounting policies followed by the Company, as summarized below, are in conformity with generally accepted accounting principles.

Principles of Consolidation—The accompanying consolidated financial statements include the accounts of the Company and its subsidiaries after elimination of intercompany accounts and transactions. The accounts and transactions of the Company's Canadian subsidiaries and division are translated at year-end rates of exchange for current assets and current liabilities, rates of exchange in effect at dates assets were acquired for properties and related depreciation, and approximate rates of exchange during the year for income accounts other than depreciation. Charges and credits to income as a result of foreign currency translation are insignificant.

Change in Accounting Method—Inventories

As of January 1, 1974, the Company changed its method of valuing sugar and packaging materials in its Chocolate and Confectionery Division from the lower of cost (first-in, first-out or average) or market, to the last-in, first-out (LIFO) method which more closely relates current costs to current revenues in periods of price level changes. The effect of this change in 1974 was to increase cost of sales by \$12,444,000 and decrease the net income by approximately \$6,002,000 or \$.46 per share.

As a result of this extension of the LIFO method of valuing inventories, substantially all of the Chocolate and Confectionery Division inventories are valued under the LIFO method in 1974. Such LIFO inventories amounted to approximately \$47,726,000 in 1974 and \$23,773,000 in 1973. The remaining inventories are stated

at the lower of cost or market under the "first-in, first-out" or "average cost" method. The excess replacement or market value over LIFO cost was \$80,554,000 at December 31, 1974 and \$39,100,000 at December 31, 1973.

During 1973, the Company reduced inventory quantities, primarily cocoa beans. This reduction resulted in a liquidation of LIFO inventory quantities carried at lower costs prevailing in prior years as compared with the average unit cost of 1973 procurements, the effect of which reduced cost of sales by \$4,500,000 and increased net income by approximately \$2,140,000 or \$.16 per share.

Depreciation—The Company and its subsidiaries follow the policy of providing for depreciation of buildings and improvements over estimated lives ranging from 20 to 50 years and of machinery and equipment over estimated lives ranging from 3 to 25 years. The companies have employed primarily straight-line methods in determining the annual charge for depreciation.

Major renewals and betterments are capitalized. Maintenance, repairs and minor renewals are expensed as incurred.

Goodwill—The excess cost of investments over net assets of the businesses acquired are carried as Goodwill in the Consolidated Balance Sheets. It is the Company's policy to carry Goodwill arising prior to November 1, 1970 at cost until such time as there may be evidence of diminution in value or the term of existence of such value becomes limited. Goodwill arising after October 31, 1970 is being amortized over a period not exceeding 40 years.

Deferred Items—Deferred development expenses consist of soil and water conservation payments and other preoperating expenses relating to the development of almond ranches by L. D. Properties Corporation, a wholly-owned subsidiary of the Company. Commencing in 1973, the first year of a substantial commercial harvest, the deferred expenses are being amortized on a straight-line basis over 18 years, which is the estimated commercially productive life of the almond trees.

Deferred location costs consist of certain expenses associated with the development and installation of new coffee service locations of Cory, a wholly-owned subsidiary. These costs are being amortized over the life of the installation, but not to exceed four years.

Development and Promotion Expenses—The cost of research and development and advertising and promotion are expensed in the year incurred.

Income Taxes—Provision for Federal and state income taxes are based on income recorded in the financial statements. Deferred income taxes arise principally from the use of different methods of depreciation for tax and accounting purposes. The reduction in income taxes currently payable, resulting therefrom, is credited to deferred income taxes in the balance sheet. The provision for income taxes has been reduced by allowable investment tax credits.

Retirement Plan—The Company and certain of its subsidiaries have a Retirement Plan covering substantially all employees of such companies. The total pension expense was \$3,149,000 in 1974 and \$2,983,000 in 1973. The Company's policy is to fund current service costs as incurred; virtually all past service liability has been funded.

The Pension Reform Act of 1974 requires the Company to amend its pension plan to conform with certain provisions of the Act, which will become effective in 1976. The Company believes that the increase in pension expense for 1976 resulting from this amendment will not exceed \$500,000, and the effect on unfunded vested benefits will not be significant.

2. Acquisitions

The Company entered into a joint venture with General Cocoa Company of New York and its affiliates which trades in cocoa products.

The Company acquired a 22½% interest in Chadler Industrial da Bahia S.A. for \$1,367,000. Chadler is a chocolate processor located in Salvador, Bahia, Brazil.

In July, 1974, Cory, a subsidiary, made a purchase acquisition of Therm Industries, Inc. for \$825,000. Therm manufactures heat transfer equipment and coffee brewing equipment for restaurant and institutional food services. The effect on the Company's earnings during 1974 and 1973, had the results of Therm been included, would not be significant.

3. Stock Option Plan

Under the terms of the 1968 Stock Option Plan, a maximum of 500,000 shares of common stock may be is-

sued to officers and key employees at not less than market value at the date such options are granted. The options are exercisable at any time until expiration, five years after granting or earlier in the event of death or other termination of employment by the optionee. During 1973 and 1974, no options were granted or exercised and all outstanding options under the Plan expired during 1973.

4. Preferred Stock

The preferred stock is convertible into the common stock of the Company on the basis of three shares of common for one share of preferred, in series, at various dates. All such Cumulative Preferred Stock must be converted by December 31, 1975. In the event of liquidation, each preferred share outstanding is entitled to the same amount as would be payable to the holder of three shares of common stock.

5. Net Income per Share

Net income per common share has been computed based on the average shares of common stock and common stock equivalents outstanding during the period (13,024,074 in 1974 and 13,023,952 in 1973). The shares of Cumulative Preferred Stock outstanding during each period have been included in the computation at their common equivalent of three shares of common for one share of preferred.

6.

Income Taxes

The provision for income taxes exceeds income taxes currently payable by \$2,301,051 in 1974 and \$1,594,518 in 1973, primarily because tax depreciation exceeds book depreciation as a result of using accelerated methods for tax purposes.

The following is a reconciliation of the provision for income taxes included in consolidated income and the amount computed by applying the Federal statutory rate to income before income taxes.

	1974		1973	
	Amount	%	Amount	%
Taxes computed at statutory rate	\$21,977,356	48.0	\$13,273,235	48.0
Increase (reductions) resulting from:				
State income taxes, net of Federal income tax benefit	2,062,840	4.5	1,342,640	4.9
Investment tax credit	(649,682)	(1.4)	(1,098,815)	(4.0)
Other, net	301,486	.6	(170,060)	(.6)
Provision for income taxes	<u>\$23,692,000</u>	<u>51.7</u>	<u>\$13,347,000</u>	<u>48.3</u>

7.

Current and Long-Term Debt

Long-term debt at December 31, 1974 and 1973 consisted of the following:

	1974	1973
	(dollars in thousands)	
7¼% Sinking Fund Debentures due 1997 with annual payments of \$1,500,000 beginning in 1978	\$30,000	\$30,000
Borrowing under Revolving Credit and Term Loan Agreement	—	18,500
Various other loans, less current portion of \$422,000 and \$429,000	1,730	2,970
	<u>\$31,730</u>	<u>\$51,470</u>

As a result of seasonal working capital requirements, the Company established lines of credit from domestic banks of \$21,500,000. Average borrowings were approximately \$800,000, reaching a maximum of \$1,200,000. The weighted average interest rate was 9¾%. Additionally, the Company had borrowings under a \$45,000,000 revolving credit and term loan agreement which averaged approximately \$8,800,000 and reached a maximum of \$21,500,000. The weighted average interest rate on these borrowings was 11¼%. No borrowings pursuant to these arrangements were outstanding at December 31, 1974.

The revolving credit and term loan agreement is with two domestic banks and allows the Company to borrow up to \$45,000,000. The outstanding balance at April 2, 1976, may be converted into a term loan with payment due in equal quarterly installments commencing July 2, 1976 and ending April 2, 1983. Interest rate is prime until April 2, 1975, ¼ of 1% above prime until April 2, 1976 and ½ of 1% above prime thereafter. As part of the agreement, the Company must pay a commitment fee equal to ½ of 1% of the unused portion of the commitment. In addition, the agreement contains certain restrictive covenants. The most significant of such covenants requires the Company as of each year end to maintain an excess of current assets over current liabilities of not less than \$45,000,000, not to permit funded debt (debt which is due in excess of one year) to exceed 66⅔% of net worth and not to permit the ratio of current assets to current liabilities to fall below 1.5 to 1.

While there were no formal compensating balance agreements under these credit arrangements, the Company has been expected to and has generally maintained average compensating balances of 15% to 20% of borrowings or generally not less than 10% of commitments.

The Company is contingently liable as guarantor of bank loans for certain affiliates, the aggregate amount not to exceed \$2,400,000 of which \$400,000 was outstanding at December 31, 1974.

8.

Lease Commitments

The Company rents and leases office space, automobiles and equipment, the aggregate annual cost of which is less than 1% of net sales.

ARTHUR ANDERSEN & CO.

1345 AVENUE OF THE AMERICAS

NEW YORK, N. Y. 10019

February 19, 1975

**To the Stockholders and Board of Directors
of Hershey Foods Corporation:**

We have examined the consolidated balance sheets of Hershey Foods Corporation (a Delaware corporation) and subsidiaries as of December 31, 1974 and 1973, and the related statements of consolidated income and retained earnings and changes in financial position for the years then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the accompanying consolidated financial statements present fairly the financial position of Hershey Foods Corporation and subsidiaries as of December 31, 1974 and 1973, and the results of their operations and changes in their financial position for the years then ended, in conformity with generally accepted accounting principles applied, other than for the change (with which we concur) in the method of accounting for certain inventories referred to in Note 1, on a basis consistent with that of the preceding year.

ARTHUR ANDERSEN & CO.



Hershey Foods Corporation
and Subsidiaries

Five-Year Financial Summary Hershey Foods Corporation and Subsidiaries

(All dollar and share figures in thousands—except market price and per share statistics)

Summary of Earnings	1974	1973	1972	1971	1970
Net Sales	\$513,999	442,710	416,171	401,880	349,636
Cost of Goods Sold	\$375,677	314,497	273,899	264,174	230,822
Operating Expenses	\$ 89,309	94,928	98,105	92,534	75,073
Interest Expense	\$ 3,227	5,632	3,610	2,754	2,915
Income Taxes	\$ 23,692	13,347	19,915	21,925	21,968
Net Income	\$ 22,094	14,306	20,642	20,493	18,858
Net Income—Per Share of Common Stock ...	\$1.70	1.10	1.58	1.55	1.41
Dividends per—Common Share	\$.80	1.10	1.10	1.10	1.10
Preferred Share	\$.60	.60	.60	.60	.45
Average number of Common Shares and Equivalents Outstanding during the year ...	13,024	13,024	13,064	13,212	13,338
Per Cent of Net Income to Sales	4.3%	3.2%	5.0%	5.1%	5.4%
Financial Statistics					
Capital Expenditures	\$ 10,887	17,564	25,137	22,602	12,012
Depreciation	\$ 8,606	7,506	6,130	5,943	5,514
Advertising	\$ 1,777	9,753	14,416	10,747	6,024
Current Assets	\$124,172	97,106	108,667	102,965	98,924
Current Liabilities	\$ 57,579	23,456	29,789	44,486	25,575
Working Capital	\$ 66,593	73,650	78,878	58,479	73,349
Current Ratio	2.2:1	4.1:1	3.6:1	2.3:1	3.9:1
Long-Term Debt	\$ 31,730	51,470	51,364	26,533	28,548
Debt-to-Equity Per Cent	18%	32%	32%	17%	19%
Stockholders' Equity	\$173,173	160,777	159,714	156,280	152,746
Stockholders' Data					
Outstanding Common Shares at Year-End	11,824	11,824	11,824	11,977	11,798
Market Price of Common Stock—					
At Year-End	\$ 9¾	12⅝	23⅞	28	26
Range During Year	\$ 8½-15	12½-24¾	21⅛-28¾	26-31⅜	21⅞-28
Number of Common Stockholders	19,362	19,095	17,980	18,346	19,128
Employees' Data					
Payrolls	\$ 72,936	74,464	67,700	62,189	54,917
Number of Employees—Year-End	7,200	8,500	8,530	9,140	8,250

 **Hershey Foods Corporation**
Hershey, Pa. 17033, U.S.A.

